MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

Room 110 Capitol Building ? P.O. Box 201711 ? Helena, MT 59620-1711 ? (406) 444-2986 ? FAX (406) 444-3036

Legislative Fiscal Analyst
CLAYTON SCHENCK

Date: March 13, 2002

To: Legislative Finance Committee

From: Terry W. Johnson
Principal Fiscal Analyst

Subject: General Fund Ending Fund Balance & Revenue Trends

Internet: http://leg.mt.gov/Reports/Fiscal/interim/GF_Revenue_March2002.pdf

INTRODUCTION

The purpose of this report is to provide the committee with the final fiscal 2001 ending fund balance for the general fund account and to also outline some of the significant revenue trends that are occurring in fiscal 2002.

At the last committee meeting in December, our office expressed concerns over some of the revenue trends that were developing based on data through the end of November 2001. This report is based on information we have received through the end of February 2002.

The report is organized in three relevant sections. The first section addresses the fiscal 2001 final general fund ending balance. Section 2 discusses fiscal 2002 general fund revenue trends and is further subdivided into “HB124 Statutory Changes”, “Impacts of Economic Trends”, and “Other General Fund Issues” components. Section 3 provides a summarization of the information presented.

FISCAL 2001 FINAL ENDING FUND BALANCE

The final unreserved general fund account balance for fiscal year end 2001 was $172.9 million. This balance is approximately $0.6 million less than the preliminary estimate supplied to the committee in October 2001. This balance has been audited by the Legislative Auditor and will be published in the Comprehensive Annual Financial Report prepared by the Department of Administration.

FISCAL 2002 GENERAL FUND REVENUE TRENDS

Based on information recorded through the end of February 2002 on the Statewide Accounting, Budgeting, and Human Resource System (SABHRS), total general fund receipts for fiscal 2002 were $722.7 million as shown in Table 1. This compares to $674.6 million collected for the same period of fiscal 2001. Total general fund collections are $48.1 million above last year’s amount, which represents a 7.1 percent increase.

Table 1
General Fund Revenue Monitoring Report For Feb. 2002

Revenue Source	Estimated Fiscal 2002	Thru Feb Fiscal 2001	Thru Feb Fiscal 2002	Dollar Change	Percent Difference	% Actual Fiscal 2001	% Estimate Fiscal 2002
Driver's License Fee	2,178,000	1,073,714	1,544,634	470,920	43.86%	56.64%	70.92%
Insurance Tax & License Fees	42,666,000	16,861,030	18,549,884	1,688,854	10.02%	39.86%	43.48%
Investment License Fee	6,580,000	4,828,321	4,179,655	(648,666)	-13.43%	81.99%	63.52%
Vehicle Tax	77,319,000	0	40,998,165	40,998,165	#N/A	#N/A	53.02%
Motor Vehicle Fee	25,182,000	6,922,977	15,154,454	8,231,477	118.90%	55.23%	60.18%
Nursing Facilities Fee	5,547,000	2,890,642	2,872,590	(18,052)	-0.62%	51.11%	51.79%
Beer Tax	2,885,000	222,929	1,644,395	1,421,466	637.63%	57.96%	57.00%
Cigarette Tax	8,057,000	4,881,138	4,781,528	(99,610)	-2.04%	58.92%	59.35%
Coal Severance Tax	9,073,000	4,640,369	4,322,498	(317,871)	-6.85%	53.56%	47.64%
Corporation Income Tax	81,543,000	45,311,063	40,154,132	(5,156,931)	-11.38%	43.71%	49.24%
Electrical Energy Tax	4,644,000	2,484,494	2,227,111	(257,383)	-10.36%	61.23%	47.96%
Wholesale Energy Tax	3,568,000	1,777,539	1,302,871	(474,668)	-26.70%	50.74%	36.52%
Railroad Car Tax	1,688,000	1,032,630	1,011,751	(20,879)	-2.02%	66.38%	59.94%
Individual Income Tax	574,995,000	332,736,286	332,157,935	(578,351)	-0.17%	59.84%	57.77%
Estate Tax	17,118,000	12,870,215	9,579,701	(3,290,514)	-25.57%	63.44%	55.96%
Metalliferous Mines Tax	4,706,000	0	0	0	#N/A	0.00%	0.00%
Natural Gas Production Tax	1,945,000	(265,495)	0	265,495	-100.00%	100.00%	0.00%
Oil Production Tax	10,462,000	5,112,812	3,372,653	(1,740,159)	-34.04%	19.62%	32.24%
Public Contractors Tax	2,441,000	1,201,840	2,409,777	1,207,937	100.51%	151.82%	98.72%
Property Tax: 1.5 Mill	1,063,000	662,378	537,879	(124,499)	-18.80%	56.53%	50.60%
Property Tax: 40 Mill	62,310,000	35,476,121	35,909,630	433,509	1.22%	55.93%	57.63%
Property Tax: 55 Mill	107,598,000	64,128,438	57,085,973	(7,042,465)	-10.98%	55.54%	53.05%
Telephone License Tax	0	133,980	31,676	(102,304)	-76.36%	100.43%	#N/A
Telecommunications Excise Tax	20,253,000	6,804,408	9,307,746	2,503,338	36.79%	36.12%	45.96%
Tobacco Tax	2,265,000	1,182,247	1,301,882	119,635	10.12%	57.73%	57.48%
Video Gambling Tax	41,518,000	6,812,997	21,637,030	14,824,033	217.58%	32.61%	52.11%
Wine Tax	1,300,000	632,686	721,537	88,851	14.04%	61.26%	55.50%
Public Institution Reimbursements	12,521,000	5,740,161	5,813,051	72,890	1.27%	42.35%	46.43%
Highway Patrol Fines	4,191,000	2,392,350	2,623,043	230,693	9.64%	60.10%	62.59%
Treasury Cash Account Interest	14,671,000	12,633,996	8,909,602	(3,724,394)	-29.48%	58.68%	60.73%
Local Impact Interest	0	82,834	0	(82,834)	-100.00%	100.00%	#N/A
Liquor Excise & License Tax	9,661,000	4,446,259	5,728,203	1,281,944	28.83%	60.55%	59.29%
Liquor Profits	5,831,000	0	0	0	#N/A	0.00%	0.00%
Coal Trust Interest	36,401,000	18,627,634	19,548,977	921,343	4.95%	49.46%	53.70%
Common School Interest and Income	48,703,000	17,757,623	15,783,922	(1,973,701)	-11.11%	37.91%	32.41%
Lottery Profits	6,249,000	1,071,401	2,609,925	1,538,524	143.60%	17.46%	41.77%
Long Range Bond Excess	0	0	0	0	#N/A	#N/A	#N/A
Tobacco Settlement	18,925,000	5,591,251	5,082,085	(509,166)	-9.11%	34.97%	26.85%
US Mineral Royalty	21,756,000	11,633,060	11,292,160	(340,900)	-2.93%	37.52%	51.90%
All Other Revenue	32,715,000	34,195,233	32,467,816	(1,727,417)	-5.05%	66.07%	99.24%
Grand Total	$1,330,528,000	$674,587,561	$722,655,871	$48,068,310	7.13%	53.14%	54.31%

This trend by itself indicates that general fund revenue growth may be slipping below expectations since total revenues were expected to increase by 9.6 percent from estimated fiscal 2001 to 2002. However, since fiscal 2001 actual revenues exceeded HJR 2 estimates by $55.8 million, a revenue growth of only 4.8 percent from actual fiscal 2001 to estimated fiscal 2002 would be required to meet HJR 2 estimates. Table 2 shows how these growth rates were calculated. If the growth rate drops below 4.81 percent, the revenue estimate contained in HJR 2 will not be achieved.

Table 2
General Fund Revenue Growth Rates

	Amount Millions	Difference Millions	Growth Rate
Estimated 2001 General Fund Revenue	$1,213.719		
Estimated 2002 General Fund Revenue	1,330.528	$116.809	9.62%
Actual 2001 General Fund Revenue	$1,269.472		
Estimated 2002 General Fund Revenue	1,330.528	$61.056	4.81%

HB 124 STATUTORY CHANGES

The aggregate growth trends mentioned above can be misleading when there have been significant statutory changes such as the implementation of HB 124 (The Big Bill). The following is a list of revenue sources that were impacted by the enactment of HB 124 and a brief description of what has occurred:

Beer Tax

Prior to HB 124, $2.80 of the $4.30 per barrel beer tax was statutorily appropriated from the state special revenue fund to incorporated cities and towns. This additional tax revenue of $2.5 million in fiscal 2002 and $2.6 million in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 637.6 percent increase.

Wine Tax

Prior to HB 124, 10.0 percent of total wine tax was statutorily appropriated from the state special revenue fund to cities, towns, and counties. This additional tax revenue of $193,000 in fiscal 2002 and $201,000 in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 14.0 percent increase.

Liquor Excise Tax

Prior to HB 124, 34.5 percent of the total liquor excise tax revenue was statutorily appropriated from the state special revenue fund to incorporated cities and towns. This additional tax revenue of $1.7 million in fiscal 2002 and $1.8 million in fiscal 2003 is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 28.8 percent increase.

Video Gambling Tax

Prior to HB 124, two-thirds of the total video gambling tax revenue was statutorily appropriated from the state special revenue fund to municipalities or towns in which the machines were located. This additional tax revenue of $27.7 million in fiscal 2002 and $30.1 million in fiscal 2003 is now deposited to the general fund. Since fiscal 2001 general fund collections include the local government allocation for the last quarter, the percent of fiscal 2001 actual collections through February is only 32.6 percent of total collections. Collections to date in fiscal 2002 are 52.1 percent of the total estimate, which is more representative of a normal receipt pattern.

Property Tax

Prior to HB 124, a portion of the financial institution corporation tax and certain motor vehicle taxes were distributed based on the ratio of a taxing jurisdiction mills to total mills levied. Therefore, portions of these revenues were distributed to the general fund as property tax for the 40 mill statewide levy and 55 mill county equalization levy share. HB 124 eliminated this distribution mechanism and required the deposit of these revenues directly to the general fund as corporation tax and motor vehicle taxes. The reduction in property tax revenue in fiscal 2002 as a result of HB 124 is expected to be $2.8 million per year. Collections to date in fiscal 2002 reflect a portion of this reduction.

Vehicle Tax

HB 124 required that taxes on all light vehicles, large trucks, trailers, motorcycles, and other vehicles be deposited in the general fund beginning July 1, 2001. Previously this revenue was distributed primarily to local governments and schools. Upon adjournment of the 57th Legislature, the total vehicle tax revenue deposited in the general fund was estimated to be $77.3 million for fiscal 2002 and $77.6 million for fiscal 2003. As of the end of February 2002, which represents seven months of vehicle tax collection activity, the amount of motor vehicle taxes collected was $41.0 million. Annualizing this amount for the entire year would yield only $67.7 million for fiscal 2002, producing a revenue shortfall of $9.6 million. However, based on detailed calendar 2001 vehicle data from the Department of Justice, it is estimated that total vehicle tax revenues may be closer to $69.7 million or $7.6 million less than the HJR 2 estimate. This shortfall is also expected in fiscal 2003. (See the March 14, 2002 LFD report on HB 124 for a more in-depth analysis of vehicles taxes.)

Motor Vehicle Fee

Prior to HB 124, certain fees such as fees for titles, registrations, and personalized license plates were collected and retained by counties. This fee revenue, including revenue from a $0.25 registration fee for disabled senior citizens' transportation costs, estimated to be $13.1 million in fiscal 2002 and 2003, is now deposited to the general fund. Since fiscal year 2001 general fund collections did not include the additional amount, collections to date in fiscal 2002 show a 118.9 percent increase.

Based on fiscal 2001 city and county fee data reported to the Department of Revenue and state special revenue data from the state accounting system, it is estimated that the increase in total motor vehicle fee revenue may be closer to $15.6 million or $2.5 million above the amount published in the *Legislative Fiscal Report, 2003 Biennium*. A similar increase is also expected in fiscal 2003. (See the March 14, 2002 LFD report on HB 124 for a more in-depth analysis of vehicles fees.)

IMPACTS OF ECONOMIC TRENDS

Changes in general economic conditions can also skew aggregate growth trends especially when the change occurs gradually throughout the year. During fiscal 2002, several economic assumptions adopted by the 57th Legislature have been progressively weakening. Although the revenues associated with these economic assumptions appeared to be within forecasts early in the fiscal year, collections in the later part of the year will show signs of slower growth. This is due to the time lag between the impacts of economic changes and when tax revenues are actually received.

The following section of the report addresses some the revenue sources that are or will be impacted by the economic changes that have been developing over the past eight months.

Individual Income Tax

Approximately 65 percent of total income reported on individual income tax returns is from wages and salaries. Based on information from the US Bureau of Economic Analysis, wages in Montana have increased by 7.0 percent from the quarter ending September 2000 to September 2001. Although this is an exceptional growth rate, Paul Polzin of the Bureau of Business and Economic Research has projected that Montana will begin to realize the impact of the national economic recession during the fourth quarter of calendar 2001 and into calendar 2002. Assuming these projections are correct, individual income tax collections should begin to show signs of weakness beginning in calendar 2002. Financial accounting records for December, January, and February of fiscal 2002 support this supposition.

In addition to wage income, over 16 percent of total income is derived from interest, dividends, and net capital gains. Using the federal discount rate as a directional indicator of interest rates, this rate has fallen from 6.0 percent in February 2001 to 1.25 percent in December 2001. The S&P 500 stock index was over 1,500 during August 2000 but has fallen to less than 1,150 by December 2001. This represents almost a 25 percent decrease in equity values.

Corporation Income Tax

Corporation income tax collections through February 2002 are $5.2 million below the comparable period of fiscal 2001. This reduction occurred even with a one-time $5.3 million payment that was not anticipated nor included in the HJR 2 estimate. The three factors that explain this significant decrease in revenues are as follows: 1) total audit revenue received through February of this year compared to February of last year is $5.1 million less; 2) two major corporations have paid about $5.0 million less in estimated taxes this year as compared to last year; and 3) the economic recession has reduced the profitability of many corporations thereby reducing corporation income tax revenues. At this time, it is difficult to determine how much corporation income taxes will be below HJR 2 estimates.

Property Tax

Most of the revenue from property taxes is determined by assessing the 95 mills against the statewide taxable value. Based on information received from the Department of Revenue, the official statewide taxable value for fiscal 2002 is $12.1 million less than estimated in HJR 2. This amounts to about $1.2 million less in general fund revenues for fiscal 2002 and a potential $2.4 million reduction for fiscal 2003.

Treasury Cash Account Interest

As mentioned under the individual income tax category, the federal discount interest rate has plummeted from 6.0 percent in February 2001 to 1.25 percent in December 2001. Since treasury cash account interest revenue is based on the amount of cash available to invest and the prevailing short-term interest rates, the revenue from this source has already shown signs of weakness. Data from the Board of Investments indicate that the to date yield on the treasury cash account is about 4.6 percent for fiscal 2002. This compares to the HJR 2 short-term interest rate assumption of 6.6 percent.

Oil Production Tax

Oil production taxes are based on the barrels of oil produced and the wellhead price. Data from the US Department of Energy, Energy Information Administration shows Montana’s average wellhead oil price for the quarter ending September 2001 was $24.00 per barrel. However, the average price for the quarter ending December 2001 declined to $17.63 per barrel, a 26.5 percent reduction in wellhead prices.

OTHER GENERAL FUND REVENUE ISSUES

US Mineral Royalty

US mineral royalty collections through February 2002 are $0.3 million below the comparable period for fiscal 2001. However, receipts at the end of January 2002 were $2.6 million above the same period of fiscal 2001. The exact cause of these fluctuations cannot be determined at this time. This is because the Department of Interior, Mineral Management Services’ computer system cannot be accessed due to a recent court order regarding the Indian trust fund. Also due to the inaccessibility of the computer system, payments Montana received in December, January, and February are estimated payments that may have to be adjusted in subsequent payments.

It should be noted that HB 226 passed by the 57th Legislature caps the amount of US mineral royalty revenue deposited to the general fund based on the revenue estimates contained in HJR 2. Any revenue received in excess of the HJR 2 estimates is to be returned to the county where the mining or extraction occurred. Pertinent sections of the bill are effective January 1, 2002.

Tobacco Settlement

As negotiated by the settling parties and specified in the Master Settlement Agreement, Montana receives a set percentage of an increasing amount of tobacco settlement money. Because the January 2002 payment to all parties was expected to increase by $76.4 million, Montana’s share was also expected to increase. However, major tobacco companies have disputed the tobacco settlement auditor calculations for prior payments and have placed a substantial amount of money into a special account that is not distributed to the settling parties until the dispute is resolved. Montana's share of the disputed amount resulted in a reduction of $811,000 for the January 2002 payment. It is unknown when this dispute will be resolved.

In addition, the amount of money each party receives is adjusted by the change in volume of cigarettes shipped nationally from the base year of 1997 - fewer cigarettes shipped means a reduction in the payment. The January 2002 payment (and all subsequent payments) was reduced because the number of cigarettes shipped in 2001 was less than anticipated. Due to this reduction, general fund collections are expected to be less than estimates contained in HJR 2 by $362,000 in fiscal 2002 and $366,000 in fiscal 2003.

Common School Interest and Income

Common school interest and income collections through February 2002 are $2.0 million below the comparable period for fiscal 2001. Most of this shortfall is due to agricultural rental fees below the estimated amounts contained in HJR 2. Since most of these rental fees are collected by the end of February, total collections for common school interest and income should be $2.0 million below HJR 2 estimates.

Coal Trust Interest Earnings/Common School Interest and Income

By the end of fiscal 2002, total general fund revenues from these two sources will be overstated by $3.4 million. This double counting occurs when mineral royalty payments are deposited to the guarantee account (a sub-account of the general fund) and when loan payments from the guarantee account are deposited to the general fund. (See the March 15, 2002 LFD report on SB 495 for a more in-depth analysis of this issue.) However, the net impact to the general fund is zero since there is a guarantee account transfer appropriation equal to $3.4 million.

All Other Revenue

This category is a number of miscellaneous, smaller sources of revenue not contained in the other individual components. Fiscal 2002 collections to date almost equal the amount estimated for the entire fiscal year. Greater than anticipated collections have occurred in three main areas: 1) wildfire reimbursements - $4.9 million; 2) certain gross vehicle weight fees - $0.4 million; and 3) $0.5 million settlement payment from Bridgestone-Firestone for false advertising.

SUMMARY

Based on data through the end of February 2002, general fund revenue collections continue to show signs of weakening growth rates. Sources of revenue that are currently below expectations are individual income tax, property tax, treasury cash account interest, common school interest and income, tobacco settlement payments, and investment license fees. Additional categories that will begin to show declining growth rates within the next quarter are oil and gas production tax, metalliferous mines tax, and potentially coal trust interest earnings.

How significantly these trends will impact the fiscal 2002 and 2003 general fund ending balance is difficult to estimate at this time. As Paul Polzin pointed out in his "*Outlook 2002*" publication, calendar "2002 depends crucially on how some of the state's major industrial facilities react to a variety of threats. It is not just the national and worldwide recession, but these firms also face issues with respect to electricity prices, management, and regulation." Companies mentioned were:

- Columbia Falls Aluminum Company
- Jore Manufacturing
- Stillwater Mining
- Montana Power Company
- ASARCO

The following table (Table 3) provides a rough estimate of the **potential** revenue shortfall that may occur in fiscal 2002. As mentioned throughout this report, there are a number of economic conditions and business decisions that may change the outcome for fiscal 2002. The revenue shortfall estimate as reflected in Table 3 is based on available data extrapolated to the end of the fiscal year. Some of the smaller sources that may be doing better than expected have not been included in the table nor have other categories that will show declining growth in the future. As fiscal 2002 proceeds, this estimate will be further refined and updated based on new information received. The probability that this shortfall will occur in fiscal 2003 is high.

Table 3
General Fund Revenue Sources
Potential Shortfall Fiscal 2002

	Estimated Millions
Individual Income Tax	($19.9)
Property Tax	(1.2)
Tresury Cash Account Interest	(1.5)
Tobacco Settlement	(0.4)
Investment License Fees	(1.5)
Common School Interest & Income	(2.0)
Motor Vehicle Tax	(7.6)
Motor Vehicle Fee	2.5
Total	($31.6)

Significant revenue adjustments not included in Table 3 are the estimated impacts of the Economic Growth and Relief Reconciliation Act of 2001 and the Job Creation and Worker Assistance Act of 2002. The first act is estimated to increase state income taxes by $13.3 million for the 2003 biennium. The most recent act; however, may reduce state income tax revenues significantly. This is because the bill allows a first-year depreciation deduction equal to 30 percent of the adjusted basis for certain qualified property acquired after September 10, 2001 and before September 11, 2004. Our office has begun to research the impact of this legislation but was unable to acquire state specific estimates in time for this report.

It should be noted that our office has examined the potential of supplemental appropriations for the Department of Public Health and Human Services, Department of Corrections, Department of Natural Resources and Conservation, and the Department of Revenue. Our review process has also included the use of the governor's emergency statutory appropriation. To the extent that supplemental appropriations materialize, the general fund balance will be further reduced beyond the anticipated shortfall in revenue collections. Subsequent reports on the March 14-15, 2002 Legislative Finance Committee agenda will address disbursement issues.

I:\Legislative_Fiscal_Division\LFD_Finance_Committee\LFC_Reports\2002\March 14\Gen_Fund_Revenue_Bal_Trend.doc